APPENDIX A

PLAN FOR ALTERNATIVE FORM OF REGULATION

Summary

Pursuant to Section 13-506.1 of the Illinois Public Utilities Act ("Act"), Illinois Bell Telephone Company ("Illinois Bell") shall be regulated under a price regulation plan for those Illinois Bell services that are classified as noncompetitive under the Act. On the first of the month following the filing of initial implementing rates demonstrating compliance with statutory imputation and aggregate revenue requirements, the price cap index, as described in Section I.A.2 (a), will be set at 100 until the first annual update on July 1, 1995. At that time, and each year thereafter, Illinois Bell may adjust its rates, within the constraints of a price cap index, which reflects the impact of inflation and productivity, as well as exogenous events and changes in service quality. There will be no direct regulatory oversight of Illinois Bell's earnings or its depreciation rates, except that the depreciation rates used to calculate the revenue requirement implementing the alternative regulation plan shall also be used by Illinois Bell for calculating long run service incremental costs through December 31, 2001. Thereafter, the Commission will no longer maintain oversight over depreciation rates used in calculating long-run service incremental costs. Such rates, however, must be the same as those used in the Company's depreciation accruals as reported to the Commission on its annual report and must be consistent with Generally Accepted Accounting Principles ("GAAP").

Section I contains rate stability provisions and other terms and conditions of the plan. Section II describes the procedures for price changes to the price index.

I. Rates and Conditions of Price Index Plan

A. Rate Adjustments

1. Rate Stability for Basic Residential Service and for Other Residential Usage

(a) Increases above the initial tariffed rates for basic residence services implementing the alternative regulation plan shall not be permitted for the first five years that the plan is in effect. Basic residence services include the monthly recurring charges for Illinois Bell's lowest priced primary residence network access line in each Access Area defined in Illinois Bell's tariffs and any associated untimed or flat local usage charges. For purposes of this paragraph, basic residence services are defined as Illinois Bell's residence network access line rates for Illinois Bell Access Areas A, B and C; Band A residence usage service; and flat rate residence usage service in those exchanges where usage sensitive service is not yet available. (Ill. C.C. No. 5, Part 2, Section 19, par. 2.5; par. 4.4, A(2); par. 5.4, A(2); par. 3.2, C; par. 3.2, E, note.) Increases above the initial tariffed rates for Band B and Band C residence usage implementing the alternative regulation plan shall not be allowed for the first five years that the plan is in effect. Decreases in the tariffed rates for basic residence service and for Band B and Band C residence usage shall be permitted under the price cap index mechanism, consistent with other provisions of the Act.

(b) After expiration of the initial five-year period of the plan, increases in basic residence services and in Band B and Band C residence usage may be made subject to the provisions of paragraphs 2 and 3, unless otherwise modified by the Commission.

2. <u>Price Cap Index-Based Rate Adjustments</u>

(a) On the first of the month following the filing of initial rates implementing the alternative regulation plan and demonstrating compliance with Sections 13-505.1 and 13-507 of the Act, the price cap index ("PCI") and the actual price index ("API"), as described in this paragraph and in paragraph 2(d), will be set at 100.00 until the first annual update on July 1, 1995. On July 1, 1995, and each year thereafter, Illinois Bell shall be permitted to change the rates for services then classified as noncompetitive in its tariffs in an amount which, when taken together with all price changes in the customer categories described in paragraphs 2(d) and 2(e) and Section I.A.1(a), will be limited to the percent change in the fixed weight Gross Domestic Product Price Index ("GDPPI"), as determined and published by the United States Department of Commerce, and an offsetting adjustment reflecting Illinois Bell's differential growth in input price and productivity, plus a consumer productivity dividend. The total offsetting adjustment will be 4.3%. In addition, an exogenous change factor ("Z") and a service quality component ("Q") are included in the determination of the price cap index for a given year, as prescribed in Section I.A.4. and I.A.5. When the initial PCI is set at 100.00, the initial values of Z and Q will be set at 0.00. The price cap index formula is as follows:

Price Cap Index (PCI) for the current year = PCI of Prior Year times [1 + (%Change in the GDPPI) / 100 - .043 +/- Z + Q]

(b) Effective with the first annual price cap filing after the Commission's Order culminating the first review of the plan, the price cap index formula with the inclusion of the merger conditions factor ("M") is as follows:

Price Cap Index (PCI) for the current year = PCI of the prior year recomputed with Q=0 times [1+((per cent of the change in the chain weight GDPPI)/100-[.033+/-Z+Q-M]) times (per cent of price cap revenue above LRSIC/100)].

(c) The PCI set forth in paragraph 2(a) or 2(b), together with the API set forth in paragraph 2(d), provide the basis for the reasonableness of price changes within the four customer categories. The four customer categories and the principal services within each category at the outset of the plan are as follows: (1) residence (residence network access lines; Band A through Band C residence usage, including volume discounts); (2) business (business network access lines; Band A through Band C usage, including volume discounts; ISDN; custom calling, advanced custom calling; ACBS; remote call forwarding; WATS; and non-recurring charges); (3) carrier (switched access, special access, cellular access and LIDB); and (4) other (directory services, Chicago name and address, payphone, directory assistance, private line and operator services; residence Starline; residence Multi-ring; residence custom calling; residence advance custom calling; and residence non-recurring charges). 911 service is excluded from the plan. Intrastate toll service is excluded from the plan but may be added at a later time, pursuant to the procedures for new services in Section I, D. (Ill. C.C. No. 5, Part 4). All access charges and resold services (wholesale) are eliminated from the plan. Simultaneously, all remaining services under the plan are combined into one basket. Consistent with the Commission's Order in dockets 96-0486/96-0569 consolidated, unbundled network elements and interconnection remain excluded.

(d) The reasonableness of price changes under the plan is determined by a comparison of the PCI applicable to a given year to the API for each of the four customer categories, one customer category beginning with the first annual price cap filing after the Commission's Order culminating the first review of the plan described in paragraph 2(c). If the proposed price changes are such that the API for each category is less than or equal to the PCI for that year, the price changes will have a presumption of reasonableness, and absent special circumstances, will be allowed to go into effect without suspension. The API may change at any time during the year when price changes are made. The API formula for each customer category as defined above is as follows:

$$API(t) = API(t-1) \sum_{i=1}^{n} v_i \frac{p_i(t)}{p_i(t-1)}$$

where:

t = any year; t-1 is the prior year;
i = rate element i in a given customer category or basket;
p_i (t) = the proposed price for rate element i in year t;
p_i (t-1) = the price for rate element i in year t-1;
v_i = the revenue weight for rate element i, which is calculated as the revenue from rate element i using demand from the most recent calendar year and the current rate divided by the revenue from all rate elements in each customer category individually using demand from the most recent calendar year and current rate; and
n = the number of rate elements in a given customer basket.

(e) Individual service price increases within each customer category are subject to two additional limitations. The price for any individual rate element may not be increased more than once in any calendar year. The price for any individual service rate element may not be increased by more than the percentage of change in the price cap index for that year over the previous year plus 2%. In addition, no intrastate carrier access rate may be increased to a level that exceeds the interstate rate for that service, unless the intrastate rate results from the implementation of a Commission policy to deviate from the mirroring process. Access price changes also remain subject to any limitations on rate structure and levels imposed by currently effective and future Commission access orders.

(f) Effective with the first annual price cap filing after the Commission's Order culminating the first review of the plan, individual service prices and individual rate elements are limited to a 15% increase in any calendar year.

(g) ~~(e)~~Illinois Bell may choose to forego any price index-based revenue increases to which it might be entitled under the plan.

(h) Revenue increases foregone in the current year pursuant to paragraph 2(f) may be made cumulatively in a following year as long as the PCI is not exceeded. Any individual rate element increases would remain subject to the limitations in paragraph (e).

(i) ~~(g)~~Illinois Bell may decrease prices for any of its noncompetitive services. Such price decreases will be included in the calculation of the API for a basket as described in Section I.A.2(c). No price will be decreased below the long run service incremental cost for that service.

3. <u>Other Rate Adjustments</u>

Individual service price changes that exceed the limits set forth in paragraph 2(d) may be made subject to the notice and filing requirements of Article 9 of the Act and not as part of the plan's rate adjustment mechanisms. The overall revenue effect of rate changes made pursuant to this paragraph must comply with the restrictions placed on the service category to which the individual service is assigned in accordance with paragraphs 2(a), 2(b), 2(c), 2(d), and 2(e).

4. <u>Exogenous Events</u>

Exogenous factor (Z) treatment will be allowed for costs which are truly outside the Company's control. Costs that will be considered should be such that they would not be picked up in the economywide inflation factor, to avoid double-counting. The financial effects of an exogenous change must be verifiable and less than a $3 million change will not be considered for exogenous factor treatment.

Specific items that warrant exogenous factor treatment include changes in federal and state tax law, to the extent they affect local exchange carriers such as IBT disproportionately, mandated jurisdictional separations changes, and changes in Commission-approved accounting or cost allocation procedures. Extraordinary costs incurred due to new and unusual regulatory requirements will be considered for exogenous factor treatment. The Company must show that actions taken by the FCC or other federal bodies would affect intrastate cost significantly in the latter case. Rate changes required to satisfy the statutory requirements of Section 13-507 of the Act also will be given exogenous factor treatment.

The term "Z" in the PCI formula will be calculated as the ratio of the amount of the exogenous change to the total company revenues for the period in which the change occurred.

The price index will be adjusted to reflect exogenous events only to the extent deemed necessary by the Commission to ensure that the conditions set forth in Section13-506.1(b) of the Act continue to be satisfied.

When exogenous factor treatment occurs outside an annual filing, the Company shall recompute the PCI from the most recent annual filing with an updated exogenous factor.

5. Service Quality Component

A service quality component ("Q") will be incorporated in the price cap index to ensure that service quality does not deteriorate during the life of the plan. There will be eight separate quality of service measures for monitoring the company's service quality. They are: (1) percent installation within five days, (2) trouble reports per 100 access lines, (3) percent out of service over 24 hours, (4) percent dial tone speed within three seconds, (5) operator average speed of answer – toll and assistance, (6) operator average speed of answer – information, (7) operator average speed of answer – intercept, and (8) trunk groups below objective.

Each measure is equally weighted and will be compared to the Company's actual performance in these areas during 1990 and 1991. The Company receives a score of zero for each service measure if it meets or exceeds the benchmark and a –0.0025 for each service measure if it fails to meet the benchmark.

The term "Q" in the price cap index will be zero if the Company meets or exceeds the benchmark for all eight service measures or –0.0025 for each service measure which does not meet the benchmark, for a maximum decrease of –0.02.

Beginning with the first annual price cap filing after the Commission's Order culminating the first review of the plan, there will be nine quality-of-service measures. They are: (1) percent installation within five days, (2) trouble reports per 100 access lines, (3) percent dial tone speed within three seconds, (4) operator average speed of answer – toll and assistance, (5) operator average speed of answer – information, (6) operator average speed of answer – intercept, (7) trunk groups below objective, (8) average speed of answer – business office, and (9) average speed of answer – repair.

The term "Q" in the price cap index will be zero if the Company meets or exceeds the benchmark for all nine service measures or –0.0025 for each measure for each consecutive year in which that measure has not met the benchmark. The maximum for any one year is –.0225 plus the component from the previous year. The service-quality component affects the PCI for only one year and the PCI is reset a year later.

6. Merger Conditions Component

A. Merger conditions component ("M") will be incorporated permanently in the price cap index in the 2003 annual filing. In all other years, the term "M" will be zero. The amount of 50% of net annual merger earnings less the amount attributable to unbundled network elements, carrier access and competitive services is the balance to be applied to the non-competitive retail and wholesale elements. The term "M" is this balance divided by the corresponding non-competitive revenues.

B.

C. Depreciation

Upon the filing of initial rates implementing the plan, Illinois Bell will adopt the depreciation rates and amortization schedules consistent with the determinations made by the Commission in its Order approving the alternative regulatory plan. Beginning on January 1, 1995, Illinois Bell shall have the flexibility to adjust its depreciation rates as it deems necessary to reflect the consumption of capital accurately, in accordance with generally accepted accounting principles, without prior Commission approval. However, for LRSIC studies, aggregate revenue tests and imputation studies only, the Company is required to apply the depreciation rates established in this proceeding. Effective January 1, 2002, the Commission will no longer maintain oversight over depreciation rates used in calculating long-run service incremented costs so long as those rates are consistent with GAAP and consistent with those used on its accounting statements to the Commission.

D. Reclassification of Services As Competitive

Illinois Bell may reclassify existing noncompetitive services as competitive in accordance with Section 13-502 of the Act. Upon reclassification, all impacted rate elements will be removed from the API and the API will be recalculated for the affected customer categories.

E. New Services

Illinois Bell may file tariffs for new noncompetitive services in accordance with the notice and filing requirements of Article 9 of the Act. The API for the affected customer categories will be adjusted and recalculated only after the service has been offered for one year. The demand weighing in the API calculation will be for the most recent one year period or for the most recent July to June period as described in paragraph 2(d)

F. Infrastructure Development

Upon approval of the plan by the Illinois Commerce Commission, Illinois Bell will commit to at least $3 billion in expenditures in Illinois for growth and modernization of the telecommunications network over the first five-year period of the plan.

G. Term

The term of the plan shall run from the date of its approval by the Illinois Commerce Commission. The Commission retains the authority under Section 13-506.1(e) of the Act to rescind the plan upon petition by Illinois Bell, any other person or upon its own motion if, after notice and hearing, the Commission finds that the conditions set forth in Section 13-506.1(b) of the Act no longer can be satisfied, or if the conditions as outlined in Section II(J) are met.

H. Temporary Price Promotions

The Company may file temporary price promotions, which are price decreases that will be in effect 180 days or less, pursuant to the alternative regulation plan. If the Company reflects the price promotion in the API, then upon the termination of the temporary price promotion, the Company must file a tariff reflecting the regular price in order to update the API.

I. Calculation of API for the Creation of a Single Basket

The Company will combine all the baskets beginning with the first annual filing after the Commission's Order culminating the first review of the plan. The API will be combined by weighting the most recent existing API prior to the effective date of that annual filing by the maximum allowable revenue in each basket. The maximum allowable revenue in each basket is the existing revenue multiplied by the PCI and divided by the basket API.

II. Rate Adjustment Proceedings

A. This section describes the procedures for rate adjustments described in Section I. A. 2. during the period of the plan. By April 1 of each year of the plan after 1994, Illinois Bell will file with the Commission:

1. The PCI for the following 12-month period (July to June), calculated in accordance with section I. A. 2. Supporting documentation will provide:

(a) then current data showing the GDPPI for the previous calendar year and the GDPPI % change for that 12-month period;

(b) then current data showing the calculation of Z for the previous calendar year, with the events causing Z to change identified and described.

(c) then current data showing the calculation of Q for the previous calendar year, with the events causing Q to change identified and described.

2. The API for each customer category, including the effects of proposed rate changes determined in accordance with Sections I.A.2(c) and I.A.2(d). The API shall be less than or equal to the PCI for the upcoming year for each customer category. Adjustments will be made for new services added, existing services withdrawn, and services reclassified as competitive or noncompetitive.

3. Tariff pages to reflect revised rates, if rate increases or decreases are proposed to be effective on July 1 of the same year.

4. Supporting documentation demonstrating that any proposed rate increases are consistent with the limitations set forth in Section I. A. 2. including:

(a) the API for each service basket, including the effects of proposed rate changes and adjustments for new services added, existing services withdrawn, and services reclassified as competitive or noncompetitive;

(b) a description of any rate increases or decreases being proposed;

(c) the maximum percent price change allowed for an individual service;

(d) the percent price change resulting from any rate increase or decrease proposed for any individual service.

5. A demonstration that Illinois Bell would be in compliance with Section 13-507 of the Act, assuming the proposed rate changes went into effect.

6. A demonstration that Illinois Bell would be in compliance with Section 13-505.1 of the Act, if rate changes are proposed for services subject to Section 13-505.1 of the Act and assuming that the proposed rate changes went into effect.

7. An identification of any modifications in the past year to the GDPPI weights, what effect the new weights have on the GDPPI and whether the PCI should be adjusted accordingly.

B. The Commission Staff and all interested parties shall have an opportunity to file written comments regarding Illinois Bell's annual filing and Illinois Bell shall have an opportunity to file reply comments. Following completion of the comment period and prior to July 1 of the same year, the Commission shall approve a PCI that will be applicable during that year.

C. Illinois Bell may file tariff pages to increase or decrease individual service rates under the price cap plan at any time during the calendar year to which the index applies.

1. In connection with such filings, Illinois Bell shall file the supporting documentation described in Section II.A.4.

2. All such tariff filings shall be made at least 45 days in advance of their effective date.

D. Tariffs filed pursuant to Sections II, A, 3 or II, C that are found to be consistent with the PCI and individual rate limitations of this plan shall enjoy a presumption that they are just and reasonable and, absent special circumstances, shall become effective without suspension or investigation under Article 9 of the Act.

E. By March 31, 1995, Illinois Bell will file with the Commission a report containing a description of the proposed projects and amount to be invested in new technology pursuant to Section I.E. for 1995 and a comparison with the actual projects and amounts invested in new technology during 1994. By March 31 of each year of the plan after 1995, Illinois Bell will file with the Commission an annual report which includes the following information. Effective with the first March 31 date after the Commission's Order culminating the first review of the plan, items 1, 2, 3, 4, 5, 6, and 7 are no longer required.

1. Total Company and Illinois jurisdictional rate base for the preceding calendar year adjusted to reflect the regulatory treatment ordered in this docket;

2. Total Company and Illinois jurisdictional operating revenue and expenses for the preceding calendar year adjusted to reflect the regulatory treatment ordered in this docket;

3. Other income and deductions, interest charges, and extraordinary items for the preceding calendar year (with explanation);

4. Preceding calendar end-of-year capital structure;

5. Calculated total Company and Illinois jurisdictional return on net utility rate base and total Company return on common equity for the preceding calendar year;

6. Statement of Sources and Applications of Funds for the preceding calendar year;

7. A description of the proposed projects and amounts to be invested in new technology pursuant to Section I. E for the current calendar year and a comparison with the actual projects and amounts invested in new technology during the preceding calendar year;

8. A calculation of the then current price cap index and actual price indexes, including the formulas used, the inflation factor and its source, the current general adjustment factor, the exogenous factor and a description of its calculation, and the service quality component and a description of its calculation;

9. A description of new services offered in the preceding calendar year including the price of each and its effect on the calculation of the API during the preceding calendar year;

10. Demand growth by revenue basket for the preceding calendar year;

11. Summary of price changes initiated under the plan during the preceding calendar year;

12. A demonstration that Section 13-507 of the Act has been complied with during the preceding calendar year;

13. A summary report on Illinois Bell's quality of service during the preceding calendar year;

14. A summary report on the exogenous events that affected the exogenous factor of the price cap formula during the preceding calendar year.

F. The annual filings set forth in Section II. A. and II. E. and the tariff documentation set forth in Section II will document that the requirements of the plan are being implemented properly, as required by Section 13-506.1(e) of the Act.

G. Application for Review of the Alternative Regulatory Plan

H. Illinois Bell shall submit an application for review of the adopted alternative regulatory mechanism by March 31, 1998, at the time it submits its annual report for 1997. In addition to a summary and analysis of the information in the infrastructure investment report filed by March 31, 1995, and in annual reports filed by March 31 of 1996, 1997, and 1998, the application for review of the price cap mechanism shall address at least the following issues:

1. Whether the inflation index and the manner in which it is applied provide an adequate reflection of economywide inflation.

2. An assessment of productivity gains for the economy as a whole, for the telecommunications industry to the extent data are available, and for Illinois Bell during the period that the alternative regulatory framework has been in place, and whether the adopted general adjustment factor should be modified.

3. Whether the adopted monitoring and reporting requirements should be retained or adjusted.

4. The extent to which Illinois Bell had modernized its network and additional modernization plans for the near term.

5. A listing of all services in each basket and a report of the cumulative percentage changes in prices for each service during the period the price cap mechanism has been in effect.

6. A listing of any services which have been withdrawn during the period.

7. A listing of all services which have been reclassified as competitive or noncompetitive during the period.

8. A summary of new services which have been introduced during the period.

9. Information regarding any changes in universal service levels in Illinois Bell's service territory during the price cap period.

10. Whether, and the extent to which, the adopted regulatory framework has met each of the established statutory and regulatory goals.

I. Application for Review of the Alternative Regulatory Plan after the Initial Review

The Company shall submit an application for review of the adopted alternative regulatory mechanism in 2007 at the time it submits its annual report for 2006, provided the plan has not been terminated pursuant to Section II J. The application for review of the price cap mechanism shall address only the following issues:

1. Whether the inflation index and the manner in which it is applied provide an adequate reflection of economywide inflation.

2. An assessment of productivity gains for the economy as a whole, for the telecommunications industry to the extent data are available, and for Illinois Bell during the period that the alternative regulatory framework has been in place, and whether the adopted general adjustment factor should be modified.

J. Termination of the Alternative Regulatory Plan

When competitive forces are present to provide alternatives to customers for the services under the alternative regulatory plan, the alternative regulatory plan will terminate and the market forces will determine prices. The alternative regulatory plan will terminate when any of the following conditions are met.

1. The Commission orders the plan terminated during a review of the alternative regulatory plan.

2. This plan will terminate thirty days after all rate elements covered by the plan have been reclassified as competitive. The thirty days may be extended by the Commission up to 11 months to resolve any complaints regarding competitive reclassifications.